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"The International Political and Economic Trends in the 80's"

by

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1. Over the past decade the international economic system has gone through a crisis which has deeply affected all aspects of world economic relations. At the beginning of the 80's it still seems very difficult to distinguish the characteristics of a possible New Economic Order. "Reaction mechanisms" set into motion by the outbreak of the crisis in the early 70's seem to be still at work with no short term stable solution being at hand. To try to discuss the possible economic trends of the decade in front of us, therefore, it is necessary to try to understand at least some of the ways followed by the international system in the attempt to find a new framework for growth and stability. Nothing guarantees, however, that "ex-ante", such a framework actually exists.

The main characteristics of the behaviour of the international economic system over the past decade as compared to that of the previous one may be summarized as follows:

- World inflation has grown in its average level, its dispersion of national economic figures, its variability and as far as minimum "floors" are concerned;
- Growth rates of real output have considerably decreased, assuming, in some cases, negative values;
- International economic relations have displayed an increased variability in trade volumes and values, (as a percentage of GNP and GDP), in capital movements as well as in exchange rate fluctuations;
- The structure of economic relations has shown a greater variety in the hierarchical setting of countries and group of countries. The traditional post-war division between

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developed, developing and planned economies is no longer a faithful description of the state of things. Developed countries are split between "strong" and "weak" economies while LDC may be grouped (to keep things simple) into "oil exporting", "newly industrialized", and "poor" countries. No single nation seems able to exert an "hegemonic" influence over the system (as the US did after World War II) so as to impose a one-sided solution to the crisis.

Interdependence between countries and groups of countries has increased. Contrary to what happened in the "boom years", when growing integration had been a powerful vehicle for growth, interdependence has become as powerful a channel for the international transmission of "crisis shocks" throughout the system. A consequence of the last two points is an increasing conflicting situation in which political, strategic and economic aspects are tangled together.

2. A possible way of looking at the economic events of the "seventies" is to consider them as the result of a "general disproportion crisis". As a matter of fact, over the past decade all relative prices and quantities have been altered.

In the OECD countries new industrial relations have brought about deep changes in the income distribution between wages, profits and "rents" while the rate of growth of productivity has considerably declined.

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The role of the state in regulating national economies has, at the same time, increased in size and deteriorated in efficiency and fine-tuningcapability while resource absorption by the public sector has increased giving rise to larger monetary expansion.

The product's share of the "exposed sector" of national economies has declined as opposed to the "sheltered sector"'s quota.

Crucial proportions have been altered also as far as North-South economic relationsare concerned. The rise in the real price of oil is the most evident example of such a "price shock" but relative prices of other commodities have also been altered, though not permanently.

If the "general disproportions" framework may be accepted, to discuss future economic trends is to ask ourselves if, when and how new "proportions" will be established so as to allow the system to set itself on a new "equilibrium" growth path.

Now, a general disproportion crisis breaks out, not just when relative price shocks occur but, also, when economic (both market and non-market) mechanisms are lacking that will enable the system to restore old proportions whenever any exogenous event changes them.

A very simple example may be represented by the "Phillips curve" relationship governing (in the past) labour markets. When such a mechanism failed industrial relations were 'structurally' altered and capital accummulation was evidently affected. This small example also suggests that when over disproportions break out the crisis may assume different aspects.

Stagnation (and stagflation) phenomena, either as a consequence of "overproduction" and/or "underconsumption", appear and different "movement laws" start to dominate market and non-market mechanisms.

In order to outline possible future economic scenarios, therefore, it is necessary to investigate the evolution of regulating mechanisms of the international system as they presently appear.

3. A first "regulating mechanism" to be considered is inflation. Observed inflation may be considered as the result of a "demand for" and "supply of" inflation.

The demand for inflation may be defined as the price level that is "desired" by market operators. Each economic agent, in other words, seeks to obtain a given monetary income in exchange for goods and services he sells. The capability of achieving such a revenue will be closely linked to his "market power" (or "degree of monopoly").

The supply of inflation may be considered the amount (and distribution) of liquidity available to finance the new derived price level.

The inflationary process will be enhanced as long as disproportions persist since economic operators, both private and public, will try to impose new proportions more favourable to them, by raising the prices of goods and services they sell. Inflation will also be enhanced as long as liquidity, both domestic and international, will expand in excess of real output growth. (Although this may sound

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"monetarist" one would like to stress the radically different market behaviour which is implicit in the present outline; as opposed to neoclassical assumptions no stable equilibrium convergence is assumed, no "invisible hand" is presumed to be at work). Persistence of inflation, in turn, induces "monetary" rather than real adjustments to disproportions and therefore fuels up the persistence of "disequilibrium" magnitudes and with them, inflation itself.

It is a rather easy forecast, one which states that almost certainly inflation will continue to accompany economic relations for many years ahead (although, possibly, at decreasing rates).

4. A second regulating mechanism is the policy attitude which may be defined as "economic nationalism".

The collapse of the Brettons Woods system and the regime of floating rates which has teken its place are the results of the attempt of policy-makers to ease, as much as possible, the external constraint, especially since alterations in the "domestic proportions" (industrial relations, sheltered versus unsheltered sectors, etc.) have made such a constraint untenable at fixed exchange rates. The external adjustment mechanisms have followed two directions, complementary to each other: in addition to floating the exchange rate to habit to finance, through indebtness in international credit markets, payments imbalance has widely developed.

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The diffusion of "beg thy neighbours" practices through exchange rate manipulation has increased inflation differentials (while different propensities to inflation, in turn have increased exchange fluctuations) deepening the division between "strong countries" which "benefit" from deflationary "virtuous circles" and weak countries which "suffer" from inflationary vicious circles.

Economic nationalism however is proving itself to be a painful illusion as growing interdependence has made adjustment costs heavier and heavier.

The tendency that, since the end of the seventies, seems to be prevailing, at least as far as monetary relations are concerned, is the research of somewhat more stable arrangements (of which the EMS is the most relevant one).

This tendency however is accompanied by the emergence of a "multi/regional monetary structure" characterised by a small number of leading economic powers (such as Germany, Japan and of course, the USA) to which smaller economies are tied. The tendency towards a number of currency areas reflects in turn the changing pattern of international trade and capital flows over which major economic powers exert control. A noteworthy consequence is the growing trend towards the establishment of a multi-currency reserve system (in which non-currency reserve assets such as gold have a place too).

5. A third regulating mechanism , strictly tied to the second one and which could not have developed without it, is the expansion of state intervention in national economies.

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The amount of resources allocated by public expenditure has increased considerably producing structural changes both on itself and on the private sector. The structure of government budgets has been marked by an increase in consumption expenditure and in transfers to the private sector while overall productivity in public services has failed to step up consistently. The larger financing requirements of the public sector have not been met by a proportionate increase in fiscal pressure due to the explicit and implicit refusal of the private sector to pay heavier taxes. This has produced an increase in deficit financing practices which in turn has produced an increase in domestic liquidity (given the less stringent external constraint).

As a result, fiscal policy has gradually lost cycle control capacity while short period "fine-tuning" has been increasingly assigned to monetary policies.

The private sector, however, has benefited from such an evolution at least in two ways. A direct one through the increased transfer flows, an indirect one through the expansion of the "underground economy" that is a productive sector which escapes fiscal and labour security costs thus easing cost pressures.

It is difficult to understand whether the state-market relationship will continue to develop according to the above-mentioned lines, it seems clear, however, that a problem of "private consensus to public behaviour" here is involved. And it is not impossible to think of a "conflicting scenario" in which a race to both more state intervention

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(as far as subsidies and transfers are concerned) and more free market practices (as far as the underground economy is concerned) will mount.

6. A fourth regulating mechanism is the exceptional expansion of private international credit markets. This expansion may be considered the result of the encounter of a number of favourable events such as, on one side, the almost complete inadequacy of official financial institutions to cope with problems generated by the first oil crisis in 1974, and, on the other hand, the convenience of practically all economic operators (monetary authorities, banks, multinational enterprises, developing countries) to allow and later on to encourage such an expansion.

The international credit markets have provided the only effective recycling mechanism of OPEC surpluses thus allowing payments disequilibria to be financed rather than adjusted. This mechanism has followed the allocative preferences of private banks. The credit distribution which resulted has somewhat increased difference between countries since the beneficiaries of private international finance are, besides most OECD countries, the small group of "NIC" as the majority of LDCs are not considered by private banks as being creditworthy.

It is not easy to predict whether the role of private banks will develop along the same lines in the years ahead. Risks of financial collapse are much higher now, after the

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second big oil price rise, as borrowers are already heavily indebted and lenders are not able to finance other than debt servicing requirements and not additional payments inbalances. As a consequence, heavy growth limitations will be imposed on oil importing countries. Financial support by private banks on the contrary could be enlarged to a wider spectrum of countries (including low-income LDCs) if some sort of cooperation between them and official institutions (such as the IMF and the World Bank) were set up. Bringing together liquidity availability of the former and risk-guarantee of the latter.

7. A fifth regulating mechanism has been the "free market New Economic Order" of which the exceptional performance of the NICs may be viewed as the main result. This mechanism has followed the allocative preferences of OCSE based multinational firms.

The NICs may be considered as the "extreme version" of the export-led model followed by industrialized countries after World War II. The NICs have benefited, in the past, from consistent flows of direct investments as well as from substantial loans from international credit markets.

Productive effort is concentrated in the outward-looking sector while domestic markets are largely under-developed and labour markets are heavily biassed in favour of the demand side. Although much of their development depends on capital flows coming from industrialized countries, competitiveness of manufactures produced by NICs

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is strongly feared by OCSE's industrial sectors.

Future progress of NICs and the possible diffusion of their economic and social models to other developing countries will depend on direct investment flows and financial availability, both coming from international market choices, while it could be negatively affected by the possible diffusion of protectionist practices in OECD countries.

8. The large number of new-regulating mechanisms produced by the international system gives the impression that the world market is quite a lively structure, although this does not deny the existence and persistence of a general crisis. New regulatory mechanisms do not necessarily produce compatible results. In other words, nothing ensures us that a new "proportionate" and stable economic system may arise from the operation of market forces. The persistence of high inflation and low growth is perhaps the most convincing demonstration of such a statement.

The possibiligy of a system finding, in a short time, a new path of high growth and stability is further pushed away if we consider the fact that one of the deepest modifications of market behaviour brought about by almost ten years of instability is what we might call the "shortening of the time horizon of the economic agents".

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A decade-long instability in all relevant economic magnitudes has greatly increased uncertainty about future trends and thus has depressed the propensity to capital accumulation. Investment preferences have shifted from long term to short term utilizations of wealth. This shift has taken up different forms according to the different agents involved.

Firms, both national and multinational, have shown an increased preference for inventories accumulation (in raw materials and manufactured goods) and in short term financial investments while growth in fixed capital investments has declined. This is especially true of investments in industrialized countries while, as mentioned, direct investments in high-income developing countries have continued, if not increased.

OPEC countries have privileged highly liquid short term investments in the international financial markets and have so far only partially been interested in acquiring shares of OCSE based industrial firms. The wide-spread monetary and financial instability has made increasingly appealing to oil producers the "portfolio alternative" of investing in ~~xxx~~ underground oil in a perspective of rising nominal and (at least) stable real oil prices.

Each of the above-mentioned choices induces a deflationary impact on the international economy. In other words, the shortening of the time horizon of economic agents has long term effects over the system. It is also clear that as long as instability prevails growth in real capital will continue to stagnate.

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If investment draws back, however, it is very difficult that new "proportions" may be established since new proportions need productive capacity to assume a structure adequate to the new relative prices prevailing in the market (the most obvious example being energy saving efforts) and hence investments are needed.

As long as proportions not compatible with long-run high growth equilibrium prevail, however, the demand for inflationary adjustments will remain strong.

As long as international liquidity remains abundant on the other hand, supply for inflation will be sufficient to finance any price increase derived from economic agents. The instability which derives in turn will keep "short" the time horizon of the investors making inflation and depressions proceed together.

9. Policy recepies which have been increasingly applied by industrialized countries seem to follow, more or less closely, the monetarist prescription of controlling money stock expansion and leaving the market forces the task of adjusting the supply side. As we have mentioned above, however, it seems unlikely that the behaviour of market forces will lead the international system back to a stable "high-growth" path. The "equilibrium" which is most likely to come out is an "ex-post" deflationary adjustment of quantities while inflationary pressures will persist as economic agents try to adjust their relative

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positions (demand inflation) and international liquidity expands and is distributed so as to supply the necessary monetary accommodations.

Many different outcomes are of course possible but the probability of their success is closely tied to non economic events.

The exceptionally high growth of the sixties was made possible, generally speaking, by the encounter of international macro-economic framework (which included a set of "rules of the game" for national policy makers) and a "micro-economic" behaviour of economic agents (firms, workers, prime material producers) which was "compatible" with such a framework (and it was compatible because the framework was either "accepted" or imposed).

Now high and stable growth will be achieved in the future if such two conditions are again met. What items seems unrealistic however is that such conditions resemble closely those prevailing before the "crisis of the seventies". A New International Economic Order is possible therefore only if political, and not just economic conflicts are solved both in North-South and East-West relations.